No. 91-587

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In the Supreme Court of the United States

OCTOBER TERM, 1991

THE INDEPENDENT INSURANCE AGENTS OF AMERICA, INC., ET AL., PETITIONERS

v.

CITICORP, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN OPPOSITION

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QUESTION PRESENTED

Whether the Bank Holding Company Act, which restricts a bank holding company's acquisition of "direct or indirect ownership or control" of voting shares of any company that is not a bank, prevents a bank holding company banking subsidiary from acquiring an insurance subsidiary.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 936 F.2d 66. The order of the Board of Governors of the Federal Reserve System (Pet. App. 22a-43a) is reported at 76 Fed. Res. Bull. 977.

JURISDICTION

The judgment of the court of appeals was entered on June 10, 1991. On August 28, 1991, Justice Marshall extended the time for filing the petition for

a writ of certiorari to and including October 8, 1991, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.* (BHCA), regulates bank holding companies by implementing a "congressional policy against control of banking and nonbanking enterprises by a single business entity." *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980). Under Section 3 of the Act, holding companies must obtain the approval of the Board of Governors of the Federal Reserve System (the Board) before acquiring banking subsidiaries. 12 U.S.C. 1842. In addition, as relevant here, Section 4 of the BHCA provides that a bank holding company may not: (1) "acquire direct or indirect ownership or control of any voting shares of any company which is not a bank"; or (2) engage in activities other than those of banking or managing or controlling banks. 12 U.S.C. 1843(a). Section 2(g) of the BHCA clarifies the reach of that provision by stating that "shares owned or controlled by any subsidiary of a bank holding company shall be deemed to be indirectly owned or controlled by such bank holding company." 12 U.S.C. 1841(g).

There are two relevant exceptions to the general prohibition on a bank holding company's acquisition of shares of non-banking subsidiaries. First, Section 4(c)(8) of the BHCA allows a bank holding company to acquire shares of a company that engages in activities that are "so closely related to banking or managing or controlling banks as to be a proper incident thereto," subject to the restriction that provid-

ing insurance as a principal, agent, or broker is not closely related to banking except in limited, specified circumstances. 12 U.S.C. 1843(c)(8). Second, the Board's Regulation Y contains a "state bank operating subsidiary rule" permitting state-chartered banks (which are regulated and insured by the Federal Deposit Insurance Corporation), to acquire, without the Board's prior approval, "all * * * of the securities of a company that engages solely in activities in which the parent bank may engage, at locations at which the bank may engage in the activity, and subject to the same limitations as if the bank were engaging in the activity directly." 12 C.F.R. 225.22(d)(2)(ii).[1]

2. The State of Delaware recently enacted legislation allowing banks chartered in that State to act as insurers and engage in the business of insurance through a separate division of the bank or through a subsidiary. 67 Del. Laws, ch. 223 (1990). Whether or not the bank chooses to perform insurance activities directly or through a separate subsidiary, Delaware requires that there be substantial structural barriers between the bank's insurance operations and its other activities. For example, the Delaware statute separates the assets and liabilities of the bank and its insurance division by providing that the assets of the bank may be applied only to satisfy the liabilities of the bank and not of the insurance divi-

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[1] There is a similar rule for national banks, which permits such acquisitions "in accordance with the regulations of the Comptroller of the Currency." 12 C.F.R. 225.22(d)(1). In December 1988, the Board requested comments on a proposal to rescind the state bank operating subsidiary rule (but not the provision for national banks), suggesting that the regulatory exemption provided by the rule might be inconsistent with the BHCA. 53 Fed. Reg. 48,915. The Board has not taken final action on this proposal.

sion, *id.* at § 8, while the assets of the insurance division may be applied to satisfy the liabilities of the insurance division only and not of the bank, *id.* at § 22.[2]

The statutory separation between the bank's insurance and banking operations is underscored by the fact that for purposes of the Delaware Insurance Code, an insurance division of a bank is treated as an insurance company "in the same manner and to the same extent as if it were a separately incorporated subsidiary * * * with separate capital accounts, assets and liabilities." 67 Del. Laws, ch. 223, § 17 (1990). Delaware law also requires that the bank may transact business with its insurance division only "on terms and under circumstances substantially the same as for comparable transactions with or involving other customers," *i.e.*, on an arm's length basis. *Id.* at § 4. Loans made by the bank to its insurance division are treated as loans to a "separate corporation" for purposes of the regulatory limits on the bank's lending function. *Id.* at §§ 4, 9.

In addition, Delaware law separates the regulation of the insurance division from that of the rest of the bank. The Insurance Commissioner, not the Bank Commissioner, has the authority to examine the operations and books of the insurance division, and to

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[2] The statute also provides that the minimum capital that the bank is required to maintain under the Delaware banking statutes may not be used by the insurance division to meet that division's separate capital requirements under Delaware's Insurance Code. 67 Del. Laws, ch. 223, § 3 (1990). The statute additionally requires that the bank must maintain financial records for its insurance division that are "separate and distinct" from the bank's other records and places limits on the amount of capital that may be allocated to the insurance division. *Id.* at §§ 4, 10.

seize the business and property of an unsafe or unsound insurance division to conserve or liquidate it. 67 Del. Laws, ch. 223, § 38 (1990). The Delaware statute also strictly limits the authority of the State's Bank Commissioner over the insurance division; unless the activities at issue are not subject to the supervision of insurance regulators, the Bank Commissioner may supervise an activity of the insurance division only if that activitiy "is likely to have a materially adverse effect on the safety or soundness of the bank." *Id.* at § 5. And while the Insurance Commissioner routinely obtains a summary of bank examinations, *id.* at § 6, and may request that a special examination of the bank be performed by the Bank Commissioner, *id.* at § 38, no parallel authority exists for the Bank Commissioner to request or obtain routine or special examinations of the insurance division. Finally, the insurance division is taxed as an insurance company, not as a bank. *Id.* at § 16.

3. Citicorp is the nation's largest bank holding company, with assets of substantially more than $200 billion. See *Citicorp*, 76 Fed. Res. Bull. 664, 664 (1990). In 1986, with the Board's approval, Citicorp established Family Guardian Life Insurance Company (Family Guardian) as a wholly owned subsidiary to underwrite and sell certain credit related insurance expressly authorized for bank holding companies by Section 4(c)(8)(A) of the BHCA, 12 U.S.C. 1843(c)(8)(A). *Citicorp*, 72 Fed. Res. Bull. 339 (1986). The day after the Delaware statute was enacted, Citicorp transferred all of the voting shares of Family Guardian to Citibank of New Castle, Delaware (Citibank/Delaware), a Delaware-chartered banking subsidiary that is insured by the Federal Deposit Insurance Corporation. Citicorp envisioned that by transferring ownership of Family

Guardian from Citicorp to Citibank/Delaware, Family Guardian would be able to transact the broader range of insurance activities authorized under the Delaware statute. Pet. App. 23a.

Petitioners, which comprise various trade associations for insurance agents and insurance companies, object to Citicorp's action. They filed a petition for enforcement with the Board, contending, among other things, that Family Guardian's activities were not permitted under the state bank operating subsidiary rule, because the barriers required by the Delaware statute in connection with bank insurance activities were so significant that Delaware banks, including Citibank/Delaware, could not engage in these activities "directly." Pet. App. 25a. The Board granted the petition and concluded that Delaware does not permit its banks to perform insurance activities "directly," because it mandates compliance with "a comprehensive set of financial, operational, and regulatory limitations that separate virtually every aspect of the insurance division's business from the bank." *Id.* at 30a.

The Board described the "pervasive financial and operational firewalls that insulate the insurance division from the bank." Pet. App. 31a. Among other things, the Board observed that the Delaware "limits on capital attributed to specific functions typically do not apply to activities within a single entity, but rather to investments in a subsidiary by a parent company." *Id.* at 30a-31a. Similarly, the statutory requirement of arm's length dealings between the insurance division and the rest of the bank is typically "imposed to regulate transactions between a bank and separate affiliates," and is ordinarily unnecessary "for activities that are being conducted within the same entity." *Id.* at 32a.

The Board also noted that Delaware treats the bank's insurance division as a corporation separate from the bank for lending limit purposes, restricts the dividends paid by the insurance division to the bank as if the bank were a shareholder of the division, rather than part of the same entity, and limits the use of certain customer information obtained by the bank in connection with credit extension requests. Pet. App. 32a. The Board concluded by observing that in regulating the bank's insurance business, Delaware law treats the bank's insurance division "almost exclusively as a company that is not a bank." *Id.* at 33a.

"While no one of these restrictions in itself is necessarily determinative," the Board emphasized, their "cumulative effect * * * is, in the Board's judgment, to compel the insurance division to function in practice for all intents and purposes as a distinct corporate entity separate from the bank." Pet. App. 30a. Under the circumstances, the Board held, Citicorp could not rely on the operating subsidiary rule to exempt it from the Board's authority. *Id.* at 38a. The Board therefore ordered Citicorp to cause Family Guardian to stop providing insurance "except as authorized and approved by the Board under section 4(c)(8)(A) of the [Bank Holding Company] Act." *Id.* at 39a.

4. The court of appeals granted Citicorp's petition for review and vacated the Board's order. Pet. App. 3a-21a. The court turned first to the Board's interpretation of its operating subsidiary rule. *Id.* at 10a-14a. It expressed "considerable wonderment" at the Board's interpretation of the word "directly" in that regulation. *Id.* at 12a. In the court's view, the Board's interpretation suggested that the Board

would be more willing to permit insurance activities had the State provided *fewer* protections for the bank's assets, since it was the nature and extent of those protections that led to the Board's conclusion that Family Guardian could not be an operating subsidiary of Citibank Delaware. *Ibid.*[3] Nonetheless, the court was "willing to assume, for purposes of this appeal, that the separation mandated by the Delaware statute precludes a bank from operating its insurance 'division' 'directly' " within the meaning of the Board's state bank operating subsidiary rule. *Id.* at 13a.

The court turned next to the question whether the BHCA allowed the Board "to regulate the activities of the subsidiary of a bank subsidiary of a holding company." Pet. App. 14a-21a. The court concluded that the BHCA does not authorize the Board to do so. *Id.* at 19a. The court recognized that the BHCA prohibits a bank holding company from acquiring "direct or indirect ownership or control of any voting shares of any company which is not a bank or bank holding company." 12 U.S.C. 1843(a)(2). See Pet. App. 4a-5a. And it acknowledged that "a literal application" of the BHCA's terms would result in the conclusion

[3] The court also stated that the Board's interpretation put "considerable strain" on the word "limitations" in its regulation, which would "sensibly apply" to requirements that a State imposed on bank subsidiaries, but not limitations that are "structural in nature." Pet. App. 12a. The court also was troubled by the response the Board's General Counsel gave to a Delaware legislator during consideration of the Delaware statute, which, in the court's view, suggested to the legislator that he had gotten an "authoritative assurance" that the separateness between the insurance division and the bank "did not preclude the bank from engaging in insurance activities 'directly.' " *Id.* at 12a-13a.

that Citicorp owns Family Guardian. *Id.* at 16a. But the court did not believe that Congress intended to "extend" Board authority to non-bank subsidiaries of holding company banks. *Id.* at 17a.

The court first noted that the Board had previously taken the position, upheld in *Independent Insurance Agents of America, Inc.* v. *Board of Governors*, 890 F.2d 1275 (2d Cir. 1989), cert. denied, 111 S. Ct. 44 (1990), that the BHCA does not grant the Board any authority to regulate banks that are owned by holding companies. Pet. App. 14a. In the court's view, this construction of the statute presumably advanced Congress's intention "to leave unimpaired the primary regulatory authority of state and national bank chartering agencies to determine the activities of institutions under their jurisdiction." *Ibid.*

The court also stated that there was no reason to believe that Congress wanted "the jurisdiction of bank chartering authorities to end at the corporate structure of the bank itself, rather than extend throughout the chain of companies owned by the bank." Pet. App. 15a. Moreover, the court found no basis for believing that Congress wished to create "two classes of state chartered banks—those owned and not owned by bank holding companies," where the only distinction between the two was whether their subsidiaries could engage in non-banking activities. *Ibid.* Finally, the court took "some comfort" in the fact that its conclusion was in accord with that of other federal bank regulatory agencies, although it conceded that it was "still obliged to begin [its] task by according deference to the view of the agency directly responsible for administering the Act." *Id.* at 19a-20a.

ARGUMENT

We adhere to our view that the BHCA prohibits a bank holding company from acquiring ownership or control of voting shares of a non-bank company by placing those shares in a wholly owned banking subsidiary. Nonetheless, we have decided against seeking further review of that issue at this time. The Second Circuit is the first court of appeals to address the issue, which is a matter solely of statutory construction. Its decision does not raise an immediate threat of unsafe banking practices, because the bank subsidiary at issue here remains subject to the regulatory jurisdiction of the State and the FDIC. Moreover, the continuing consequences of the decision are unclear. The issue may be affected by banking law reforms that were proposed in the recently adjourned session of Congress. In light of those considerations, the decision in this case does not warrant this Court's review.

1. The BHCA provides that no bank holding company shall "acquire direct or indirect ownership or control of any voting shares of any company which is not a bank." 12 U.S.C. 1843(a)(1). Additionally, the BHCA expressly provides that "shares owned or controlled by any subsidiary of a bank holding company shall be deemed to be indirectly owned or controlled by such bank holding company." 12 U.S.C. 1841(g)(1). In this case, there is no dispute that Citicorp is the holding company for Citibank Delaware, which acquired all of the shares of Family Guardian. Family Guardian is a life insurance company and not a bank.[4] The Board therefore reason-

[4] Because Family Guardian is neither an "insured bank" under the Federal Deposit Insurance Act nor an institution

ably concluded that Citicorp had acquired "indirect ownership or control" of the voting shares of a non-bank, within the meaning of Section 4 of the BHCA, and that Citicorp was therefore required to show compliance with the Board's operating subsidiary rule.[5]

The court of appeals acknowledged that a "literal application" of the BHCA's terms supports the Board's decision, but concluded nonetheless that it had been given "no reason to believe that Congress wanted the jurisdiction of bank chartering authorities to end at the corporate structure of the bank itself." Pet. App. 15a. The court, however, has no authority to redraft the BHCA because it "deem[ed] its results susceptible of improvement," *Badaracco* v. *Commissioner*, 464 U.S. 386, 398 (1984); *TVA* v. *Hill*, 437 U.S. 153, 194-195 (1978), or because the

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that (1) accepts demand or similar deposits and (2) makes commercial loans, it plainly falls outside the BHCA's definition of a "bank." See 12 U.S.C. 1841(c)(1).

[5] Even if that were not rightly the "end of the matter," as petitioners observe, Pet. 12 (citations omitted), the structure and the legislative history of the BHCA also support the Board's construction. For example, the exemption provided in Sections 4(c)(2) and 4(c)(4) of the Act for voting shares acquired by "any banking subsidiary of a bank holding company," Pub. L. No. 84-511, §§ 4(c)(2), 4(c)(4), 70 Stat. 133, 136, would have been unnecessary if Congress had not intended the Act's non-banking prohibitions to apply to holding company banks. Moreover, the policy underlying the BHCA "against control of banking and nonbanking enterprises by a single business entity," *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980); see S. Rep. No. 1095, 84th Cong., 1st Sess. Pt. 1, at 1 (1955), is plainly advanced by interpreting the BHCA to reach the non-banking activities of holding company bank subsidiaries.

statute, as written, "yield[s] anomalies." *Board of Governors* v. *Dimension Financial Corp.*, 474 U.S. 361, 374 n.7 (1986). The court erred in applying its own notions of legislative consistency—by its own admission, hardly a hallmark of the statutory process, Pet. App. 18a—in the face of the contrary terms of the BHCA.

2. Despite the court of appeals' error, review of the decision below by this Court is not warranted. As an initial matter, there is no direct conflict between the court of appeals' decision and that of any other court on the statutory issue presented here. Indeed, the Second Circuit is the first court of appeals to address the issue. Thus, review by this Court is not necessary to "bring about a uniformity of decisions" on the issue presented by this case. R. Stern & E. Gressman, *Supreme Court Practice* 197 (6th ed. 1986). See Sup. Ct. R. 10.1(a).

Additionally, the court's conclusion that the Board lacks authority over subsidiaries of banks owned by holding companies does not leave such subsidiaries in a regulatory vacuum. As the court emphasized, the bank chartering agencies (state or federal, as the case may be) have "ample authority" to determine the permissible activities of bank subsidiaries "[b]y virtue of their authority over the banks that they charter." Pet. App. 15a. Moreover, to the extent that the parent banks are federally insured—as all banks owned by holding companies are required to be, 12 U.S.C. 1842(e)—the activities of their subsidiaries are subject to the FDIC's powers to protect the deposit insurance fund. The existence of other regulators with undoubted authority over subsidiaries of banks owned by holding companies substantially diminishes the force of petitioners' extended specula-

tion, Pet. 7-11, about the dangers they expect to flow from the court of appeals' restriction of the Board's jurisdiction.

Finally, the errors below involve solely questions of statutory interpretation, and thus are subject to correction by Congress. Congress recently had before it a number of proposals for comprehensive banking law reform, including proposals that specifically address the permissible insurance activities of national and state banks and their subsidiaries.[6] These pro-

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[6] Congress took action with respect to the insurance activities of subsidiaries of insured state banks. The Senate and House conferees agreed on a bill, entitled the Federal Deposit Insurance Corporation Improvement Act of 1991, which sets out restrictions on those activities. Section 303 of the bill would amend the Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq.*, by adding a new Section 24, which would provide in the pertinent part of subsection (d) as follows:

> (2) INSURANCE UNDERWRITING PROHIBITED.—
>
> (A) PROHIBITION.—Notwithstanding paragraph (1) [authorizing subsidiaries of adequately capitalized state banks to engage in FDIC-approved non-bank activities], no subsidiary of an insured State bank may engage in insurance underwriting except to the extent such activities are permissible for national banks.
>
> (B) CONTINUATION OF EXISTING ACTIVITIES.—Notwithstanding subparagraph (A), a well-capitalized insured State bank or any of its subsidiaries that was lawfully providing insurance as principal in a State on November 21, 1991, may continue to provide, as principal, insurance of the same type to residents of the State (including companies or partnerships incorporated in, organized under the laws of, licensed to do business in, or having an office in the State, but only on behalf of their employees resident in or property located in the State), individuals employed in the State, or any other person to whom the bank or subsidiary has provided insurance as

posals were matters of intense congressional interest, which is likely to be renewed in the upcoming congressional session. Thus, the practical importance of the court of appeals' decision may be short-lived. Given the absence of a conflict among the decisions of the courts of appeals and the absence of an immediate threat to bank safety, there is no need for the Court to address the question presented here at this time.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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DECEMBER 1991

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principal, without interruption, since such person resided in or was employed in such State.

(C) EXCEPTION.—Subparagraph (A) does not apply to a subsidiary of an insured State bank if—

(i) the insured State bank was required, before June 1, 1991, to provide title insurance as a condition of the bank's initial chartering under State law; and

(ii) control of the insured State bank has not changed since that date.

S. 543, 102d Cong., 1st Sess. § 303 (1991). See 137 Cong. Rec. H11,793 (daily ed. Nov. 26, 1991). This bill has not yet been presented to the President for his signature.

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